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February 1, 2006

PUBLIC DOCUMENT

Case No. A-823-812
Total Pages: 21
plus 1 CD-ROM

VIA MESSENGER

David Spooner
Assistant Secretary for Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th Street & Constitution Avenue, NW
Washington, DC 20230

Re: Status of Ukraine as a Non-Market Economy Country Under the Antidumping and Countervailing Duty Laws: Rebuttal Comments

Dear Assistant Secretary Spooner:

The Ad Hoc Committee of Domestic Nitrogen Producers ("Ad Hoc Committee")[1] hereby submits rebuttal comments in response to the Department's request for further comments on whether Ukraine should continue to be treated as a non-market economy country under U.S. antidumping law. See 71 Fed. Reg. 2904 (Jan. 18, 2006). As the Ad Hoc Committee has demonstrated in its previous submissions to the Department on this issue,[2] despite certain progress, the Ukrainian economy does not yet sufficiently operate on market principles to permit

[1] The members of the Ad Hoc Committee are CF Industries, Inc., PCS Nitrogen Fertilizer, L.P., and Terra Industries, Inc.

the Department to utilize domestic prices and costs in its antidumping analyses. There have been, and the record reflects, no significant changes in the Ukrainian economy in the past six months that would warrant a different outcome at this time. In particular, the Ukrainian government continues to control the natural gas sector, setting prices for gas to domestic industrial consumers that are far below market prices. Given the importance of the natural gas sector to the Ukrainian economy, the Department must, at a minimum, recognize that state control over this sector continues to significantly distort costs and prices to industrial consumers, making them an unreliable measure of normal value under U.S. antidumping law.

It is telling that the letters submitted to the Department on January 25, 2006 in support of Ukraine's graduation to market economy status offer no evidence of any additional fundamental restructuring of the Ukrainian natural gas sector. For example, the submission of the Ukrainian Association of Ferrous Metallurgy Enterprises ("UkrMet") merely notes (at 7) that the Ukrainian government has announced plans to privatize several large state-owned enterprises, but Naftohaz Ukrayiny, the state-owned natural gas monopoly, is not among them. UkrMet also asserts (at 8) that prices are set by the market, except for public utilities, but again offers no evidence that natural gas prices are market-based. Further, although a number of U.S. corporations that operate in Ukraine submitted letters in support of Ukraine's graduation to market economy status, these letters do not provide any evidence that the Ukrainian economy operates on market principles as determined by the Department's criteria. Instead, the letters are more notable for their qualified endorsement of Ukraine's economic progress. For example, Cargill AT, which states that it is one of the largest U.S. investors in Ukraine, says that its support for market economy status for Ukraine does not "imply that Ukraine has become a fully mature, stable, and

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[2] See Letters to Acting Assistant Secretary Joseph A. Spetrini, July 11, 2005 and August 31, 2005.

transparent economy" and that "{t}here is of course more progress to be made in making the Ukrainian economic environment completely open and market driven. . . ." General Electric and the AES Corporation note in their letters that "market-oriented business conditions are continuing to improve in Ukraine," but provide no detailed analysis regarding the extent of such "improvements," and imply that further improvement is required.

The reality, however, is that a significant portion of the Ukrainian economy remains subject to government control and interference.[3] In particular, there is no evidence demonstrating that the Ukrainian government has undertaken any reform of the natural gas sector, as Naftohaz Ukrayiny remains under government control and subject to significant political interference, and gas prices continue to be set by the government at below-market prices. The recent crisis over a new contract between Russia and Ukraine for natural gas purchases demonstrates that little, if anything, has changed to suggest that the gas sector operates on market principles or free of government interference. As discussed in the attached articles, Gazprom, the Russian government-controlled gas monopoly, attempted late last year to steeply increase the price of natural gas to Ukraine, sparking a political dispute between Russia and Ukraine that has been widely criticized as an attempt by the Putin government to exert political control over Ukraine. The dispute was nominally resolved when an agreement was reached under which Ukraine will purchase gas from a trading company, RosUkrEnergo, for $95 per 1,000 cubic meters, in a complicated scheme whereby RosUkrEnergo will purchase gas from Gazprom for $230 per 1,000 cubic meters and cheaper gas from Turkmenistan for sale to Ukraine. RosUkr Energo itself has also come under increased scrutiny for its secretive operations and ownership.

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[3] See the Ad Hoc Committee's July 11, 2005 Submission at 12-26, Aug. 31, 2005 Submission at 2-6.

Thus, if the deal is affirmed, Ukraine will continue to obtain natural gas at below-market prices, albeit at a higher price than it paid previously. However, the government has made it clear that it intends to continue to keep natural gas prices to both residential and industrial consumers at non-market determined levels. As reported in the Kyiv Post,[4] the Ukrainian Prime Minister announced in January that the government will keep the price to residential consumers at about $45 per 1,000 cubic meters. Further, although the government may raise prices to industrial consumers from the current price of $85 per 1,000 cubic meters, some experts have suggested that this increase should rise to no more than $110 per 1,000 cubic meters. Thus, the government-controlled price of natural gas will continue to be well below market prices, which will continue to affect the entire Ukrainian economy. As noted in the attached "Energy Bulletin" article, "the cheapness of natural gas has several negative consequences for Ukrainian economy. . . Ukraine subsidizes energy-wasting industries. . . By keeping the price of gas low, the Ukrainian government has actually stimulated energy-wasting industries, such as steel production, heavy machinery and the chemical industry."[5] While recent events may eventually lead to reforms, there is no evidence that reform has yet occurred and Naftohaz Ukrayiny continues to give "huge subsidies to metallurgy and chemical industries" through supply of below-market priced gas.[6]

Finally, the Ad Hoc Committee notes that several parties have suggested that the EU's recent graduation of Ukraine to market economy status for purposes of EU antidumping law is germane to the Department's analysis. However, the Department must base its decision on the record before it in this proceeding, which clearly demonstrates that Ukraine has not made

[4] "Yekhanurov: Ukraine Will Try to Hold Gas Prices Steady for the Public," Jan. 6, 2006, at Attachment.
[5] Energy Bulletin, "Natural Gas Dilemma in Ukraine," Nov. 8, 2005.
[6] Id.

sufficient progress toward market principles for graduation under U.S. law. The Ad Hoc Committee also respectfully emphasizes that the Department must carefully examine the energy sector, in particular the natural gas sector, and recognize the distorting effects of continued government control over the pricing of natural gas. If, despite the absence of support on the record, the Department decides to graduate Ukraine to market economy status, it must at a minimum acknowledge the need to disregard costs and prices that do not reflect market principles in its antidumping analyses.

The original and six copies of these comments, along with a CD-Rom version, are hereby submitted to the Department.

Respectfully submitted,

Valerie A. Slater

Valerie A. Slater

Counsel to the Ad Hoc Committee
of Domestic Nitrogen Producers
202-887-4112

Attachment

washingtonpost.com

Russia-Ukraine Dispute Deepens Over Gas Prices

Associated Press
Friday, December 30, 2005; A28

KIEV, Ukraine, Dec. 29 -- Ukraine dug in its heels Thursday in a bitter dispute with Russia over natural gas deliveries, with President Viktor Yushchenko rejecting a multibillion-dollar loan offer by Russian President Vladimir Putin to help Ukraine adjust to a huge price increase.

With Russia threatening to stop supplying gas to the former Soviet republic on New Year's Day if no solution is found, Ukraine's state-run gas company said the nation's 48 million people would not freeze and its factories would not go dark if Moscow followed through on the threat.

At a second day of talks in Moscow, Russian authorities stuck by their demand that Ukraine pay more than four times the current price. The negotiations were to resume Friday.

Russia appeared to tighten the screws by signing a new deal to buy natural gas from Turkmenistan that analysts said would leave the Central Asian nation with less to sell to Ukraine, which relies on Russia for about a third of its gas and Turkmenistan for 45 percent.

The dispute has further damaged relations between Russia and Ukraine, whose ties have been strained by the ascendancy of the pro-Western Yushchenko a year ago.

Gazprom, Russia's state-run gas monopoly, says it plans to halt deliveries to Ukraine on Jan. 1 unless it agrees to pay about $230 per thousand cubic meters -- up from the $50 it pays now.

In televised comments, Putin said Russia offered to lend Ukraine up to $3.6 billion to help it pay the higher price. Yushchenko rejected the offer, the Interfax news agency reported. "Ukraine will rely on its own resources under a clear, correctly and objectively formed price," Yushchenko said.

washingtonpost.com

Russian, Ukrainian Gas Companies Agree to Complex Price Scheme

By STEVE GUTTERMAN
Associated Press Writer
Wednesday, January 4, 2006; 4:26 AM

MOSCOW (AP) -- Russia and Ukraine reached a deal Wednesday to resume gas shipments to Ukraine under a complex price scheme, ending a standoff that raised fears of long-term shortages in Europe.

The agreement was announced in Moscow by the heads of OAO Gazprom and Naftogaz, the two countries' state-run natural gas companies.

Russia stopped selling natural gas to the Ukraine on Sunday after its neighbor balked at a fourfold price increase. European customers reported a sharp falloff of gas supplies on Monday.

Europe gets about a quarter of its gas from Russia, much of it by way of pipelines that cross Ukraine. Moscow accused Ukraine of siphoning off Europe-bound gas, a charge Ukraine denied.

Under the agreement, Russia's Gazprom will sell gas to a trading company for $230 per 1,000 cubic meters and Ukraine will buy gas from the company for $95. The trading company, Rosukrenergo, can charge Ukraine lower prices because it receives cheaper gas from Turkmenistan.

"We are fully satisfied with the agreement," Gazprom chief Alexei Miller said.

Gazprom spokesman Sergei Kupriyanov said the agreed price was $230 as of Jan. 1 but that it would fluctuate with the market. He did not indicate how often the price would be adjusted.

Naftogaz chief Oleksiy Ivchenko said that the two companies had also agreed to a 47 percent increase in the transit fee Gazprom pays to send its gas through Ukrainian pipelines.

Russia last year supplied about a third of the gas consumed in Ukraine, a country of 48 million.

Gazprom initially demanded that Ukraine pay $230 per 1,000 cubic meters, four times what Ukraine was paying for Russian gas in 2005.

Many observers saw Russia's gas price demands as part of a strategy to punish Ukraine for turning toward the West politically in the past year. Historically Russia has dominated Ukraine.

After a wave of criticism from Europe, Russia boosted the amount going into Ukrainian pipelines late Monday and supplies in Europe appeared to be returning to normal on Tuesday.

Both sides appealed for help from the European Union -- of which neither country is a member.

Russian Prime Minister Mikhail Fradkov called on EU member nations to put pressure on Ukraine to ensure that natural gas transiting the country reaches Europe.

Ukrainian President Viktor Yushchenko asked the EU to mediate, saying "it is impossible not to see a scenario aimed at energy pressure and blackmail," according to a statement from the Ukrainian Foreign Ministry.

Representatives of European Union member states and the gas industry were meeting Wednesday in Brussels to discuss how to respond and how to deal with future threats to Europe's gas supply.

Although European countries including Austria, Slovakia and Hungary reported their gas supplies had returned to normal Tuesday, the gas fight has reawakened European fears over Russia's reliability and potential for belligerence -- criticism that comes as the country assumes the chairmanship of the Group of Eight, a position it wants to use to boost its international prestige.

U.S. State Department spokesman Sean McCormack on Tuesday decried "the use of energy for political purposes."

Rosukrenergo is jointly owned by Gazprom bank and a Swiss subsidiary of Austria's Raiffaisen Bank.

AP-ES-01-04-06 0426EST

washingtonpost.com

Russia's Energy Politics

Wednesday, January 4, 2006; A16

RUSSIAN PRESIDENT Vladimir Putin once again has overplayed his hand. In his zeal to reestablish Moscow's dominion over Ukraine, he has, as he did during the Orange Revolution, triggered an international crisis that could end up weakening rather than strengthening Russia's international position. Mr. Putin hoped that by shutting off gas supplies to Ukraine on Sunday, he could undermine its democratic and pro-Western government. Instead, he has provided a timely wake-up call to Western European countries dependent on Russian energy supplies. Those nations now see how Mr. Putin understands the question of "energy security," which he would make one of the principal topics for discussion by the Group of Eight this year.

For Ukraine and other former Soviet republics, Russia's crude use of energy for political ends is an old story. For years Moscow has been using its control over natural gas to reward neighbors who submit to its political diktat, such as Belarus, and punish those who seek greater independence, such as Georgia and Moldova. It has also been trying to gain control over pipelines carrying gas and oil, as well as electricity networks, by using gas as a lever. That leverage is considerable: Russia holds more than a quarter of the world's gas supplies and is a major supplier to virtually every country in Europe.

Ukraine used to be one of Moscow's pampered clients. In 2004, as part of his overt attempt to install a pro-Moscow puppet as Ukrainian president, Mr. Putin promised to heavily subsidize Ukraine's gas for years to come. But his meddling catalyzed the Orange Revolution, which gave Ukraine a democratic government determined to preserve its independence. So now Mr. Putin, acting baldly through the state-controlled company Gazprom, is seeking to quadruple the price Ukraine pays just weeks before parliamentary elections in which pro-Moscow parties are bidding to regain power. In partially shutting down supplies on Sunday, Mr. Putin calculated that Ukraine would allow Russian gas free transit to countries farther west through the same pipeline -- or, if it did not, that Western governments would blame Kiev.

Instead, when gas pressure fell off sharply yesterday in Vienna, Rome and Paris, it was Mr. Putin who was reproached -- including by such customers as Germany, which recently agreed to a controversial plan for a new pipeline under the Baltic Sea. Mr. Putin was forced to back down, though the underlying price dispute with Ukraine remains unresolved. He has a sensible way out of the conflict, which the Bush administration is urging on him: a negotiation in which Ukraine agrees to a gradual shift toward world market prices. Poland and the Baltic countries have cut such deals with Russia in the past -- though the prices they pay Gazprom are nowhere near what Mr. Putin proposed to charge Ukraine.

Even if Mr. Putin adopts this course, Western countries should absorb an important lesson. Without a prosperous or technologically advanced economy and with greatly reduced military strength, Mr. Putin hopes to restore Russia's world-power status through its control of gas. That inevitably means manipulating supplies to other countries for political ends. Western countries that do not wish to receive Mr. Putin's ultimatums -- from Germany, France and Britain to the United States, which is being pressed by Russia to line up as a major customer for new Arctic gas fields -- should realize that dependence on Russian gas is not consistent with "energy security." Instead they should develop alternative sources of supply, or a greater emphasis on nuclear energy. Russia cannot be allowed to hold its neighbors, or the world, hostage during a future cold winter.

WWW.UCIPR.KIEV.UA
Ukrainian Center for Independent Political Research
Український незалежний центр політичних досліджень

Central Asian Gas: Lost to Europe after Russian-Ukrainian Deal?

Date: Tuesday, January 10 @ 16:07:24
Topic Economics

Vladimir Socor

The Russian-Ukrainian gas agreement, signed on January 4 for a five-year period, guarantees Russia's monopoly on the transport and marketing of Central Asian gas to Europe. Although this situation is equally detrimental to Ukraine and Europe, the agreement is so framed as to entrap Ukraine into Russia's monopolistic gas transport system in Eurasia. The Kremlin has achieved this goal by offering Ukraine a deceptively discounted price on Russian-delivered Turkmen gas.

The silver lining on this situation is the chance for the European Union and Ukraine to use this five-year period in order to negotiate direct access to Central Asian gas and initiate the construction of pipelines bypassing Russia, such as the long-proposed trans-Caspian pipeline for Turkmen gas. However, official Kyiv has other ideas. It now proposes to increase Russia's intake of Turkmen and other Central Asian gas, as long as the additional volumes pass through Ukraine en route to Europe.

Until the final days of 2005, Kyiv had sought to sign a contract directly with Turkmenistan, for the delivery of 40 billion cubic meters of Turkmen gas in 2006 to Ukraine at $50 per 1,000 cubic meters. Turkmen President Saparmurat Niyazov was, however, firmly insisting on a price of $60 per 1,000 cubic meters (up from $44 in 2005), and he turned down Yushchenko's repeated invitations to visit Ukraine. Nevertheless, Prime Minister Yuriy Yekhanurov, Fuel and Energy Minister Ivan Plachkov, and Naftohaz Ukrainy chairman Oleksiy Ivchenko all reported to the Ukrainian public during December that the contract had been signed at $50; and President Viktor Yushchenko assured the nation that this was the case as late as December 29.

On the day of Yushchenko's speech, however, Gazprom president Alexei Miller was in Ashgabat signing the contract for delivery of 30 billion cubic meters of Turkmen gas in 2006 to Russia at $65 per 1,000 cubic meters. With Gazprom thus outbidding Naftohaz and controlling the sole transit route, this was an offer that Turkmenistan could hardly refuse. Considering also Turkmenistan's contractual commitment to Iran for 8 billion cubic meters in 2006, very little Turkmen gas remains available for Ukraine or other consumer countries.

As Niyazov noted during the signing, Turkmenistan would have to almost double its gas exports, to more than 80 billion cubic meters, if it were to deliver 40 billion cubic meters to Ukraine on top of the commitments to Russia and Iran. The 80 billion cubic meters figure seems realistic for the medium term; but it would only contribute to Ukraine's and the European Union's supply diversification and security if the added volumes bypass Russia en route to the consumer countries. Otherwise, delivering the added volumes to Gazprom or its offshoot RosUkrEnergo for resale to Ukraine and Europe would strengthen Russia's leverage even further.

Under the January 4 agreement, RosUkrEnergo shall purchase 41 billion cubic meters of Turkmen gas as well as 15 billion of Kazakh and Uzbek gas in 2006, and roughly equivalent amounts in 2007. The Kazakh and Uzbek volumes are intended for swap deals with South Caucasus countries, again through RosUkrEnergo as the intermediary. The Turkmen gas is to be used as follows: 26 billion cubic meters annually to supply Ukraine, and 15 billion to be retained by RosUkrEnergo as its commission, to be sold [evidently in lucrative European markets] "jointly with Gazexport," which is Gazprom's subsidiary and a parent company of RosUkrEnergo.

Meanwhile, Gazprom has practically monopolized the use of the Uzbek and Kazakh sections of the "Central Asia-Center" export pipeline that runs from Turkmenistan via those two countries to Russia. That aging pipeline operates well below its design capacity. Under agreements signed by Gazprom in September in Tashkent and in November in Astana, those sections' throughput capacity is to be increased from some 45 billion cubic meters annually at present to 55 billion cubic meters annually in 2006-2010. This period is coterminous with the Russian-Ukrainian deal, and is apparently meant to reserve the Central Asia-Center pipeline's entire available capacity for Russia to absorb almost the entire volume of Central Asian gas exports. Thus, Ukraine and European consumer countries are cut off from direct access to Turkmen gas.

Yushchenko intends to meet Russian President Vladimir Putin and propose to him the construction of additional pipeline capacities from Central Asia via Russia to Ukraine, for transit to European countries. This is the wrong way to proceed. Instead of lobbying for further expansion in the volume of Central Asian gas under Russian control, Ukraine and its friends should urge Brussels and Washington to revive the trans-Caspian pipeline project, which is now being amply vindicated by the Kremlin's behavior.

(Interfax-Ukraine, UNIAN, December 31-January 9; see EDM, January 3, 4, 5, 6, 9)

The Jamestown Foundation, EURASIA DAILY MONITOR, Tuesday, January 10, 2006 - Volume 3, Issue 6

The New York Times
nytimes.com

PRINTER-FRIENDLY FORMAT SPONSORED BY

February 1, 2006

Ukraine Gas Deal Draws Attention to Secretive Importer

By ANDREW E. KRAMER

MOSCOW, Jan. 31 — Four weeks after Ukraine cut a deal to import natural gas through RosUkrEnergo, a shell entity based in Switzerland, the obscure company is facing an uncomfortable amount of attention.

After becoming one of Europe's biggest energy traders overnight with the Ukraine deal, the company promised changes to become more open about its operations. Gazprom, the Russian gas giant, owns half of the company; its other owners have not been disclosed. The plush terms the company has received in the past from Gazprom are also a matter of much speculation.

RosUkrEnergo's secretive nature has driven the Parliaments of both Ukraine and Russia to open investigations; meanwhile, Russian journalists have tried to untangle the skein of shell companies and subsidiaries in the ownership structure.

On Tuesday, Ukrainian authorities approved one element of the Jan. 4 agreement. The antimonopoly committee cleared RosUkrEnergo to distribute natural gas inside Ukraine through a joint venture with Naftogaz, the Ukrainian national gas company. But the overarching agreement to import gas from Russia into Ukraine seems to be adrift, amid a growing din of criticism.

Last month, a member of the RosUkrEnergo board acknowledged that the company was struggling with its new profile after functioning as a behind-the-scenes intermediary in natural gas deals in the former Soviet Union on behalf of its undisclosed international investors.

"We have an image problem," Wolfgang Putschek, a member of the board of RosUkrEnergo said. Mr. Putschek represents the unnamed investors on the board.

"Something that was set up as an economic intermediary has become a very political enterprise," he said in an interview from Vienna, where he is based. "Therefore, we are open to attack by all the political forces."

RosUkrEnergo, which owns no physical assets, has a dozen or so employees at an office in Zug, Switzerland. The company made $500 million in before-tax profits last year, according to Mr. Putschek.

RosUkrEnergo's role has been to import natural gas from Central Asia to Ukraine through pipelines owned by Gazprom, a service Gazprom is able to deliver without an intermediary making huge profits, analysts say. Ceding this business to an outside company is estimated to cost Russia's majority state-owned natural gas monopoly — and Russian taxpayers as well as Ukrainian natural gas customers — hundreds of millions of dollars.

It is unclear how profitable the latest deal will be to RosUkrEnergo in its role of exclusive supplier of both Russian and Central Asian natural gas to Ukraine.

The investigations in Russia and Ukraine are opening a window on the widespread use of shell companies and offshore dealing, a business practice that proliferated in the 1990's in Russia and remains mostly in the shadows, with the curtain rising briefly only in times of crisis.

One glaring example emerged during an unstable period in the 1990's, when Russian investigators tracking suspected money-laundering traced $70 billion to the address of a shack on Nauru, a tiny island nation in the Pacific. The money was tied to the Russian mafia and, as the schemes unraveled, Western nations imposed sanctions on the island.

In December 2004, a unit of the oil company, Yukos, was sold at a questionable auction to the Baikal Finans Group, an unknown company with a registered address at a dingy cellphone store 170 miles outside Moscow. Baikal paid $9.37 billion, well below the estimated $14 billion to $22 billion value of the unit, and then swiftly sold it to Rosneft, the Russian government-controlled energy company. The sale was interpreted as the beginning of a partial nationalization of Russian oil assets.

RosUkrEnergo evolved from a previous entity registered in a Hungarian village, which grew out of a trading firm called Itera. The newspaper Novaya Gazeta in Russia reported last week that Itera fueled the high-roller lifestyle of a generation of politically connected business tycoons in both Moscow and Kiev, the capital of Ukraine.

Yulia V. Tymoshenko, the former prime minister of Ukraine, has said the current deputy director and the former chief executive at Naftogaz were among the beneficiaries. Neither man responded to phone requests for comment.

In addition, Ms. Tymoshenko's campaign director, Oleksandr Turchinov, who is a former director of Ukraine's secret police, has hinted that an accused Russian organized crime kingpin, Semyon Mogilevich, plays a prominent role in the company. Mr. Mogilevich has been linked to crimes including the 1990's money-laundering scheme in Nauru. Mr. Turchinov was quoted in the newspaper Ukrayinskaya Pravda as saying Mr. Mogilevich had had a hand in the company's operations since 2004.

Mr. Mogilevich is wanted by the F.B.I. on suspicion of racketeering, securities fraud and money-laundering, according to the agency's Web site. The site says Mr. Mogilevich, who also goes by the alias Seva, is believed to be living in Moscow.

Mr. Putschek, however, flatly denied any beneficiary of RosUkrEnergo had criminal ties.

Under the contract that settled the gas dispute between Russia and Ukraine, RosUkrEnergo will buy Russian natural gas for $230 per thousand cubic meters and sell it to Ukraine for $95 for the same volume. It will make up the difference by either selling gas in Europe, where the price is around $230 per thousand cubic meters, or by blending the Russian gas with cheaper fuel from Central Asia. Analysts say the potential for profit depends on the fuel mix and the volumes re-exported to Western Europe.

RosUkrEnergo's unnamed investors are represented by Raiffeisen Investments, a branch of the Raiffeisen Zentralbank, based in Vienna. Mr. Putschek, who represents the Raiffeisen investors, says that RosUkrEnergo operates in strict compliance with European banking law. He said he knew the investors, and that the law stated that their names never needed to appear on any stock register; that the shares were owned as bearer instruments, which operate like currency, meaning that whoever possesses the stock certificates owns the company. The certificates are typically kept in bank safe deposit boxes, Mr. Putschek said.

Mr. Putschek said that his shareholders' representatives gathered for board meetings in Zug, but generally exercised no control over operational questions of gas supply or shipment.

"The industrial leadership is with Gazprom," he said. "Formally, it's 50-50, but in practice Gazprom is the leading partner. As Raiffeisen, we won't have any say" over operations.

RosUkrEnergo, he said, "enables Gazprom to accept compromises that are face-saving for all parties involved." Gazprom could not directly accept the Ukraine deal, but through RosUkrEnergo, it could. "On the other hand, it's very clear that Gazprom controls the pipelines," he added.

But the company's role as a front for the unnamed owners has become an embarrassment for Gazprom, according to analysts who follow the company. Officials in Russia and Ukraine have urged greater openness.

One way of opening the ownership structure would be to sell the Raiffeisen stake to Naftogaz, which Mr. Putschek said the investors might consider, though Ukrainian officials downplayed that possibility. For now, however, he said, RosUkrEnergo is planning an initial public offering. That would be a first for an offshore operator with an obscure past from the former Soviet Union.

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TOP STORIES

Yekhanurov: Ukraine will try to hold gas prices steady for the public

Jan 06 2006, 19:17

New gas deal between Ukraine and Russia must be hammered out within six months

KYIV (AP) - Ukraine will try to hold gas prices steady for residents in this former Soviet republic even though the government is now paying almost twice as much under a complicated deal with Russia, the prime minister said Friday.

Yuriy Yekhanurov said the government would aim to keep the price at about $45 for 1,000 cubic meters. The price for industry, which is currently about 422 hryvna ($85), will be determined by Jan. 17, Yekhanurov said. Some experts have suggested that Ukrainian industry could survive on prices of $110, adding that it would force the energy-inefficient chemical and steel industries to adopt new technologies.

Ukraine and Russia ended their gas row on Wednesday with a deal under which Ukraine must pay $95 for 1,000 cubic meters of gas from Russia and Central Asia, almost double what it had been paying for Russian gas.

Russia had wanted to quadruple the price - and under the deal its state-controlled gas monopoly Gazprom will sell gas meant for Ukraine to a middleman trading company, Rosukrenergo, at the $230 it had demanded from Kyiv.

Under the contract, Ukraine is locked into purchasing 34 billion cubic meters of gas - or 45 percent of its total needs - from the partly Russian-owned Rosukrenergo for $95 per 1,000 cubic meters. That price is guaranteed only for the first half of the year, said Serhiy Lukyanchuk, spokesman for Ukraine's state-controlled Naftogaz. Changes must be agreed to by both sides, Lukyanchuk said.

Rosukrenergo will supply Ukraine with a mix of gas that it buys from Gazprom and the former Soviet Central Asian nations of Turkmenistan, Kazakhstan and Uzbekistan. Some Ukrainian media reports suggested that the mix would not include Russian gas, but Lukyanchuk said that Ukraine will not know whether Gazprom supplies are included.

"We aren't interested in that," Lukyanchuk said.

Ukraine will also receive 22 billion cubic meters from Turkmenistan as part of a separate deal for $50 per 1,000 cubic meters in the first half of the year, and for $60 per 1,000 cubic meters in the second half of the year, Lukyanchuk said - contradicting Gazprom officials who have said all Ukraine's imported gas will come from Rosukrenergo.

Ukraine also relies on 20 billion cubic meters of natural gas from its own sources, Lukyanchuk said.

In 2007, Ukraine will buy up to 58 billion cubic meters from Rosukrenergo, according to the contract.

The hard-fought deal with Russia came after Moscow temporarily turned down the taps, sparking concern across Europe, which receives its the bulk of its Russian gas supplies via Ukrainian pipelines. Russia's Interfax news agency quoted Gazprom spokesman Sergei Kupriyanov as saying that the contract could not be altered.

"Any deviations from this contract are just impossible," he was quoted as saying. "Any unilateral actions can lead to the only result, namely, disruptions in energy supplies to Ukraine."

Later Friday, Gazprom and Naftogaz released a joint statement declaring that they had "successfully resolved the contradictions ... the conflict is over."

Yekhanurov, meanwhile, suggested that another agreement would be needed between Russia and Ukraine, since the one already signed was just between Gazprom and Naftogaz. He said that agreement would spell out Russia's obligations, since the Central Asian gas will flow via Russian-owned pipelines.

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Energy Bulletin

Published on Tuesday, November 8, 2005 by Energy Bulletin

Natural gas dilemma in Ukraine

By Serhiy Blavatskyy

Ukraine may soon face severe gas shortages due to a possible rise in prices for natural gas imported from the Russian Federation and Turkmenistan.

The Russian gas monopoly "Gazprom" is considering raising prices for Ukraine three-fold to 170-180 dollars per 1000 cubic meters in contrast to the current price of 50 dollars per 1000 cubic meters. Turkmenistan is also considering raising the natural gas price for Ukraine. Turkmenistan is discontented with the current level of payments and wants Kiyiv [Ukraine] to pay full price for imported gas. After the last visit of Ukrainian Prime Minister Jurij Jehanurov there were even rumours that Ashgabat, the biggest supplier of natural gas to Ukraine (50%), will stop gas supplies to Ukraine in 2006.

The simultaneous price hikes by Russia and Ashgabat allow us to conclude that their actions are fully or partly coordinated. The situation is aggravated by a bilateral agreement between Gazprom and Uzbekistan signed in late September about the use of the transit capacities of Uzbek gas pipelines (50 billion m3 of natural gas per year). The agreement means that Ukraine is fully cut off from the Turkmenistan natural gas supply. Gazprom and the Kremlin can celebrate their triumph over Ukraine.

Gas negotiations between Russia and Ukraine

Let us analyse the situation. Russia, as the biggest supplier of natural gas to Europe, is as dependent on Ukraine as Ukraine is on Russia. According to the long-term agreement between Russia and Ukraine, until 2013 Russia will transport about 130 billion m3 of natural gas via the Ukrainian gas transport system. In exchange, Ukraine gets about 24 billion m3 of natural gas. Experts say that Russian Federation will be reliant on Ukrainian gas pipelines for 20 years. Even if the North-European gas pipeline is built, Ukraine will have a monopoly on Russian gas supplies to EU because of growing gas demand in Europe.

Since 2000, Russia and Ukraine have been negotiating the terms and conditions of a joint gas transport consortium for operating the Ukrainian gas pipelines. The Russians insisted the consortium was necessary to guarantee Russian gas supplies to Ukraine. Ukraine had only one objection to the proposal – it wanted to involve Germany and other big European consumers of Russian natural gas in the consortium. The Ukrainian proposition was logical since the gas consortium would have a three-party structure: the supplier of gas (Russian Federation), the transport party (Ukraine) and the consumer (the EU). However, Gazprom objected since this proposal would decrease its control over the Ukrainian gas pipelines. The presence of the German gas company "Ruhrgas" and other European consumers of natural gas (France and the UK) would be a guarantee of the energy sovereignty of Ukraine over the world's second-largest gas transport facilities.

The real problem of Ukrainian energy policy - addiction to cheap natural gas

But this fuss about a possible rise in gas prices diverts attention from the major problem of Ukrainian energy policy. Since 1991 when Ukraine declared its independence, it did nothing to cut its gas consumption. Moreover, the energy capacity of Ukrainian production per unit of GDP has more than doubled since independence. Ukraine is the fifth-largest consumer of natural gas after the USA, Japan, Russia and Germany. These are absolute figures. However the GDP of those countries is ten times larger than that of the Ukrainian. Thus, in real terms (in a calculation of 1000 m3 for 1000 dollars), Ukraine is the biggest consumer of natural gas in the world. The low price of imported gas from Russia actually costs a lot for Ukrainian economy. Almost 15 years have passed, but Ukrainian authorities have done nothing to slow the pace of this catastrophe, i.e. the volume of gas consumed by Ukraine.

Ukraine's gas addiction is appalling. The government should do everything possible to cure the Ukrainian gas addiction; it should not reduce the price of this "drug." The former government tried to do something – it dismissed a committee for energy conservation. That action, of course, was a sheer absurdity.

The negative consequences of cheap natural gas

Today Ukraine, as always, tries to maintain the status quo, directing its efforts at asserting its position in the gas market. However, the cheapness of natural gas has several negative consequences for Ukrainian economy:

First, Ukraine subsidizes energy-wasting industries. Large amounts of gas consumption in Ukraine are a legacy of the energy-wasting economy of Soviet Union. Although one Soviet leader, Leonid Brezhnev, said that the "economy should be economical," all the heavy industries that dominated the Soviet economy were energy wasting. This was not surprising since gas and oil were very abundant and cheap. Since the collapse of the Soviet Union in 1991, Ukraine has done literally nothing to stop guzzling cheap natural gas. By keeping the price of gas low, the Ukrainian government has actually stimulated energy-wasting industries, such as steel production, heavy machinery and the chemical industry. These industries also severely harm the environment.

The second consequence of cheap natural gas concerns investment priorities. A low price in natural gas gives investors incentives to pour funds not into IT or knowledge-based industries, but into those based on raw materials with low added value. The problem is similar to that of countries rich in energy sources like Saudi Arabi). These countries invest dividends from the oil and gas windfall into gas and oil extraction, neglecting other industries.

The only difference between Ukraine and those countries is that Ukraine doesn't exploit its natural resources, but rather its geographical position. However, with the advent of new energy technologies such as LNG, the geographical position of Ukraine will no longer be a competitive advantage.

The third consequence of inexpensive gas involves market status. The Ukrainian state company "Naftogaz Ukrajiny" gives huge subsidies to metallurgy and chemical industries. Thus it gives foreigners a justification for trade barriers since production in these industries is subsidized by artificially cheap gas. Besides, it hinders Ukraine from acquiring market economy status and entering the WTO and the EU. Ukrainian exporters actually suffer from low gas prices because they create problems in external trade (for example, numerous anti-dumping investigations).

The fourth consequence has a direct relation to the low salaries in Ukraine. In highly developed countries of the West, the percentage of salaries in the cost of end-production is about 60 %. In Ukraine it is about 10 %. In contrast, the cost of energy and raw materials in Ukrainian production is 80%. In other words, the current state of affairs in the Ukrainian economy is favourable only for owners of enterprises and people who control gas supplies to Ukraine. It also makes possible the "shadow economy" which is now accountable for 40 % of the Ukrainian economy.

Efficiency and energy taxes

What can Ukrainian authorities do to solve this dilemma? It is obvious that the period of low prices in natural gas for Ukraine will end soon. Most experts predict price hikes next year after parliamentary elections. It is clear that the Ukrainian government should react right now to prevent an economic crisis triggered by the rise in gas prices. In fact, the Ukrainian authorities should have improved the energy efficiency of the Ukrainian economy back in the late 1990s when the economy stabilized and global gas prices were not very high. Today Ukraine urgently needs to reform taxation policy, shifting towards energy taxes (that is what Western countries did back in 1970s after the "oil shocks"). If Ukraine wants to join the EU and become less dependent on imported fuels, it has to introduce energy taxes within the next year or so. The time to debate such a reform has already run out.

~~~~~~~~~~~~~~~ Editorial Notes ~~~~~~~~~~~~~~~~~~

It's encouraging to read energy analyses from countries beyond the Anglophone world of the US, UK, Australia and NZ.

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Article found at :
http://www.energybulletin.net/newswire.php?id=10226

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